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Federal Communications Commission

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Before the

Federal Communications Commission

Washington, DC 20554

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In the Matter of )  
 )  
 Federal-State Joint Board on ) CC Docket No. 96-45  
 Universal Service )

**NINTH REPORT & ORDER AND  
EIGHTEENTH ORDER ON RECONSIDERATION**

Adopted: October 21, 1999

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By the Commission: Commissioners Ness and Tristani issuing separate statements;  
 Commissioner Powell concurring in part and issuing a statement; Commissioner Furchtgott-  
 Roth dissenting and issuing a statement.

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## I. INTRODUCTION

1. In the Communications Act of 1934 (Act),<sup>1</sup> as amended by the Telecommunications Act of 1996 (1996 Act),<sup>2</sup> Congress codified the Commission's historical policy of promoting universal service to ensure that consumers in all regions of the nation have access to telecommunications services.<sup>3</sup> Specifically, in section 254 of the Act, Congress instructed the Commission, after consultation with the Federal-State Joint Board on Universal Service (Joint Board), to establish specific, predictable, and sufficient mechanisms to preserve and advance universal service.<sup>4</sup>

2. Based on recommendations from the Joint Board in the *Second Recommended Decision*,<sup>5</sup> and building on the framework the Commission set forth in the *First Report and Order*<sup>6</sup> and the *Seventh Report and Order*,<sup>7</sup> we establish in this Order a new federal high-cost support mechanism that will be sufficient to enable non-rural carriers'<sup>8</sup> rates for services

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<sup>1</sup> 47 U.S.C. § 151, *et seq.*

<sup>2</sup> See Pub. L. No. 104-104, 110 Stat. 56 (1996).

<sup>3</sup> According to the Joint Explanatory Statement, the purpose of the 1996 Act is "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition . . . ." Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. at 113 (Joint Explanatory Statement).

<sup>4</sup> 47 U.S.C. § 254(a), (d). See also *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order Establishing Joint Board, 11 FCC Rcd 18092 (1996) (*Universal Service NPRM*).

<sup>5</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Second Recommended Decision, 13 FCC Rcd 24744 (Jt. Bd. 1998) (*Second Recommended Decision*).

<sup>6</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776 (1997), as corrected by *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Erratum, FCC 97-157 (rel. June 4, 1997), *aff'd in part, rev'd in part, remanded in part sub nom. Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999), *petition for stay granted in part* (Sept. 28, 1999), *petitions for rehearing and rehearing en banc denied* (Sept. 28, 1999) (*First Report and Order*).

<sup>7</sup> *Federal-State Joint Board on Universal Service, Access Charge Reform*, CC Docket Nos. 96-45, 96-262, Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report & Order in CC Docket No. 96-262, and Further Notice of Proposed Rulemaking, 14 FCC Rcd 8077 (1999), *petition for review filed sub nom. Vermont Department of Public Service v. FCC*, No. 99-60530 (5th Cir., filed June 23, 1999) (*Seventh Report and Order*).

<sup>8</sup> Non-rural carriers are those that do not meet the following statutory definition of a rural telephone company:

The term "rural telephone company" means a local exchange carrier operating entity to the extent that such entity-

supported by universal service to remain affordable and reasonably comparable in all regions of the nation. The support determined by the mechanism described in this Order will replace the support that non-rural carriers currently receive from the existing high-cost fund, which provides support for intrastate rates and services.<sup>9</sup> The new high-cost support mechanism described in this Order provides support based on the estimated forward-looking costs of providing supported services. The forward-looking costs and the cost model that we will use to estimate them are discussed at length in the companion *Inputs Order* adopted today.<sup>10</sup> With the adoption of this Order and the *Inputs Order*, the Commission's new forward-looking high-cost support mechanism for non-rural carriers will be ready to begin providing support effective January 1, 2000.

3. Our methodology for determining non-rural carriers' high-cost universal service support conforms to the 1996 Act's goals and balances the competing interests involved in this proceeding. As the 1996 Act requires, the Commission has developed policies for reforming high-cost support in consultation with the Joint Board, and this Order reflects

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(A) provides common carrier service to any local exchange carrier study area that does not include either-

(i) any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or

(ii) any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;

(B) provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(C) provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(D) has less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the Telecommunications Act of 1996.

47 U.S.C. § 153(37).

<sup>9</sup> We intend to address the support that may be implicit in interstate access charges in a future order, jointly captioned in this proceeding and our access charge reform proceeding. See, e.g., *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers, Petition of US West Communications, Inc. for Forbearance from Regulations as Dominant Carrier in the Phoenix, Arizona MSA*, CC Docket Nos. 96-262, 94-1, 98-157, CCB/CPD File No. 98-63, Fifth Report and Order and Further Notice of Proposed Rulemaking, FCC 99-206 (rel. Aug. 27, 1999); *Sunshine Restrictions Applicable to Access Charge Reform* (CC Docket No. 96-262), *Price Cap Performance Review for Local Exchange Carriers* (CC Docket No. 94-1), and *Federal-State Joint Board on Universal Service* (CC Docket No. 96-45) *Lifted with Regard to Issues Raised in the July 29, 1999, Ex Parte Submission of the Coalition for Affordable Local and Long Distance Services in CC Docket Nos. 96-45, 96-262, 94-1, and 99-249*, Public Notice, FCC 99-214 (rel. Aug. 11, 1999).

<sup>10</sup> *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High-Cost Support for Non-rural LECs*, CC Docket Nos. 96-45, 97-160, Report and Order, FCC 99-304 (rel. Nov. 2, 1999) (*Inputs Order*).

deference to states' interests and needs.<sup>11</sup> We also have attempted to balance the various and often countervailing concerns of many industry segments that have an interest in the outcome of this proceeding, including incumbent local exchange carriers (LECs), interexchange carriers (IXCs), competitive LECs, and wireless carriers.

4. Because of the disparate interests involved and the complexity of the issues, however, this has not been an easy process. For example, high-cost states, which are likely to be net recipients of high-cost support, have very different views on universal service than low-cost states, which are likely to be net payors of high-cost support. On the other hand, all states have expressed similar concerns about the Commission's jurisdiction. Similarly, incumbent LECs in high-cost states, which are likely to be major recipients of support, particularly in the near term, have very different views than other LECs, IXCs, and wireless carriers, which are major contributors to federal support mechanisms. In some cases, however, IXCs and wireless carriers are entering competitive local service markets, so that these carriers are both contributors and potential recipients.

5. The 1996 Act charged the Commission with resolving the difficult issues surrounding universal service, within prescribed guidelines, and so we must balance the competing interests of these divergent parties. In this proceeding, the Commission has done so in a way that is faithful to the statute's commitment to ensuring that support mechanisms serve "*consumers* in all regions in the nation," and that consumers in high-cost areas continue to have access to reasonably comparable services at reasonably comparable rates.<sup>12</sup>

## II. EXECUTIVE SUMMARY

6. Consistent with the 1996 Act, and based on the recommendations of the Joint Board, we adopt in this Order a new federal forward-looking high-cost support mechanism to enable states to ensure the reasonable comparability of non-rural carriers' intrastate rates.<sup>13</sup> Specifically, we are adjusting and finalizing the framework of the new mechanism for non-rural carriers that we adopted on May 27, 1999, in the *Seventh Report and Order*. In the *Seventh Report and Order*, the Commission adopted a two-part methodology for calculating high-cost support for non-rural carriers that considers: (1) the relative costs of providing supported services in high-cost areas, and (2) the states' ability to support those costs using their own resources. In the first part of that methodology, the forward-looking costs of

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<sup>11</sup> We have carefully considered states' concerns as they have been expressed to us in the Joint Board's recommendations and our ongoing consultations with the state members and staff, as well as in comments filed in this proceeding by states not directly represented on the Joint Board.

<sup>12</sup> 47 U.S.C. § 254(b)(3) (emphasis added).

<sup>13</sup> Carriers also recover a portion of their costs through interstate rates. We will address reform of universal service support in interstate rates in our ongoing access charge reform proceeding. See *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing and End User Common Line Charges*, CC Docket Nos. 96-262, 94-1, 91-213, and 95-72, First Report and Order, 12 FCC Rcd 15982 (1997) (*Access Charge Reform Order*).

providing supported services, as calculated by a cost model, are compared to a national benchmark. In the second part of that methodology, a state's ability to support the costs that exceed the national benchmark is estimated by multiplying a fixed dollar amount by the number of lines served by non-rural carriers in the state. Federal support would then be provided for costs that exceed both the benchmark and the state's estimated ability to support those costs.

7. For the reasons discussed below, however, we are adjusting the framework of this methodology so that it will better reflect the historical and statutory roles of federal and state universal service support programs. As the Joint Board has suggested, we believe that the primary role of federal high-cost support is to enable reasonable comparability of rates *among* states, while the primary role of state high-cost support is to ensure reasonable comparability of rates *within* states.<sup>14</sup> In *Texas Office of Public Utility Counsel v. FCC*, the United States Court of Appeals for the Fifth Circuit found that the principles set forth in section 254(b), which include the principle of reasonable comparability, are policy goals, not legal obligations.<sup>15</sup> Thus, the Fifth Circuit held that the Commission did not have an unambiguous legal obligation to support intrastate services, and that the Act did not unequivocally establish that all federal universal service support should go to support rates for intrastate services.<sup>16</sup> The Fifth Circuit nevertheless confirmed that federal universal service support may be used to support rates for intrastate services.<sup>17</sup> The court also found that the Commission could set conditions that states must satisfy to be eligible to receive such federal universal service support.<sup>18</sup> Regardless of the extent to which the Commission is legally obligated to support intrastate services, we find that, as a matter of policy, federal universal service high-cost support should be sufficient to enable reasonably comparable rates among states, while leaving states with sufficient resources to set rates for intrastate services that are reasonably comparable to rates charged for similar services within their borders. Because the Commission does not set rates for intrastate services, the decision we adopt today is intended to allow states to ensure that rates are reasonably comparable within their borders. We find that this is consistent with the goals that Congress established in section 254(b)(3).

8. In fulfilling the federal goal of enabling states to set rates that are reasonably comparable to rates in other states, we do not believe at this time that it is appropriate for the federal high-cost support mechanism for non-rural carriers to assume that state support mechanisms will supply a particular amount of support above the national benchmark to

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<sup>14</sup> See *Second Recommended Decision*, 13 FCC Rcd at 24760, paras. 37-39; *Seventh Report and Order*, 14 FCC Rcd at 8094, para. 35, 8101, para. 46, 8102, para. 48, 8128, para. 105.

<sup>15</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 411-12, 425.

<sup>16</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 425-26.

<sup>17</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 444.

<sup>18</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 444.

enable reasonable comparability of rates among states. Rather, states should be free to use the full extent of their own resources to fulfill their primary role in the federal-state high-cost support dichotomy, i.e., ensuring reasonable comparability of rates within states. We find that we can ensure that state resources are accounted for in determining federal support amounts by considering the average cost of providing the supported services in the entire area of the state served by non-rural carriers. We base this judgment on the facts before us and the characteristics of the overall mechanism that we are adopting herein. Therefore, we reconsider and eliminate the second part of the two-part methodology described in the *Seventh Report and Order*, and conclude that the goal of the federal high-cost mechanism should be to provide support to non-rural carriers based solely on the extent to which the costs of providing supported services in high-cost areas exceed the national benchmark.<sup>19</sup>

9. In this Order, we also are filling in the framework of the revised methodology for non-rural carriers to address certain implementation issues on which we sought comment in the *Seventh Report and Order*. These issues include the area over which costs should be averaged; the level of the national benchmark; the amount of support to be provided for costs above the national benchmark; targeting support to high-cost areas; the hold-harmless and portability provisions; and the methods to ensure that non-rural carriers use support in compliance with the 1996 Act. In addition, consistent with our commitment to protect rural carriers' support levels during our reform of non-rural carriers' high-cost support, we are modifying our existing high-cost support mechanism to ensure that support for rural carriers is not substantially changed when non-rural carriers are removed from that mechanism and begin receiving support from the new forward-looking support mechanism.

10. The following is a summary of the salient points of the high-cost support mechanism for non-rural carriers that we adopt today. Each of these points is discussed in greater detail in the sections below.

- The forward-looking costs estimated by the cost model are averaged at the statewide level.
- The national benchmark is set at 135 percent of the national average forward-looking cost per line of providing supported services.
- The forward-looking high-cost support mechanism provides support for all intrastate forward-looking costs per line that exceed the national benchmark.
- The amount of support indicated by the forward-looking high-cost support

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<sup>19</sup> As discussed in the *Seventh Report and Order*, the Commission adopted the Joint Board's recommendation to use costs as a proxy for rates. *Seventh Report and Order*, 14 FCC Rcd at 8092-93, paras. 32-33. The Commission concluded that comparing costs in different states, rather than rates, allows the federal mechanism to provide sufficient support to enable reasonably comparable rates without having to evaluate the myriad state policy choices that affect those rates. *Seventh Report and Order*, 14 FCC Rcd at 8092-93, paras. 32-33.

mechanism on a statewide basis is targeted so that the amount of support available to a competitor depends on the wire center cost of the line that the competitor serves.

- Pursuant to the interim hold-harmless provision, a carrier will receive the greater of the amount of support provided to that carrier under the current mechanism or the amount of support provided by the forward-looking mechanism. Hold-harmless support is determined on a per-line basis; if a carrier loses a line, it loses the support for that line. Hold-harmless support is targeted, based on wire center costs, to the highest-cost wire centers.
- Pursuant to the portability provision, when a competitor acquires a customer from an incumbent receiving support, the competitor will receive the incumbent's support.
- States must certify that non-rural carriers receiving federal high-cost support will use that support in compliance with section 254(e) of the Act. To the extent that forward-looking support calculations exceed support levels based on the current mechanism, no non-rural carrier in a particular state will receive federal support based on forward-looking costs until that state files the required certification with the Commission. No non-rural carrier in a particular state will receive *any* federal support after January 1, 2001, if that particular state has not filed the required certification with the Commission.

11. The Commission will use this methodology to provide high-cost universal service support to non-rural carriers effective January 1, 2000. The support mechanism for rural carriers will remain unchanged at least until January 1, 2001, and reform will be undertaken only after the Commission, the Joint Board, and a Rural Task Force appointed by the Joint Board have selected an appropriate methodology for rural support.<sup>20</sup>

### III. BACKGROUND

#### A. Historical High-Cost Universal Service Support

12. The purpose of high-cost universal service support has always been to enable access to telecommunications service in areas where the cost of such service otherwise would be prohibitively high. Historically, this purpose has been achieved by providing high-cost support to incumbent LECs to enable them to serve high-cost customers at below-cost rates. This support has been both explicit and implicit.

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<sup>20</sup> *First Report and Order*, 12 FCC Rcd at 8889, para. 204, 8917-18, paras. 252-56. See also *Federal-State Joint Board on Universal Service Announces the Creation of a Rural Task Force; Solicits Nominations for Membership on Rural Task Force*, CC Docket No. 96-45, Public Notice, 12 FCC Rcd 15752 (1997) (*Rural Task Force Public Notice*).



## 1. Explicit Support

13. Several federal and state programs have provided explicit monetary payments to support the local loop and switching costs of incumbent LECs serving high-cost areas.<sup>21</sup> The most significant program for non-rural carriers that we are addressing in this phase of our universal service proceeding is the current high-cost loop support mechanism, which provides increasing amounts of explicit support based on the amount by which an incumbent LEC's loop costs, as reflected in its books, exceed the national average.<sup>22</sup> Beginning with loop costs between 115 percent and 160 percent of the national average, the current federal support mechanism for incumbent LECs with more than 200,000 lines provides support for 10 percent of the incumbent LEC's book loop costs (in addition to the 25-percent allocation of all loop costs to the interstate jurisdiction), and provides gradually more support as those costs exceed 160 percent of the national average.<sup>23</sup> The following chart summarizes the levels of support provided by the current high-cost support mechanism for large incumbent LECs:<sup>24</sup>

Loop Cost as a % of the National Average	Amount of Intrastate Loop Cost Supported
greater than 115%, but not greater than 160%	10%
greater than 160%, but not greater than 200%	30%
greater than 200%, but not greater than 250%	60%
greater than 250%	75%

14. Historically, the dial equipment minutes (DEM) weighting program, now called the local switching support program,<sup>25</sup> has provided support for the switching costs of incumbent LECs with fewer than 50,000 lines. Because most of these companies meet the

<sup>21</sup> A local loop is the connection between the telephone company's central office building and the customer's premises. A switch is a mechanical or electrical device that selects, opens, and closes circuits or paths.

<sup>22</sup> Pursuant to section 36.631 of the Commission's rules, the current high-cost mechanism provides greater levels of support for study areas reporting 200,000 or fewer working loops than for study areas reporting more than 200,000 working loops. See 47 C.F.R. § 36.631(c), (d).

<sup>23</sup> 47 C.F.R. § 36.631(d). The existing high-cost loop support mechanism provides gradually more support for costs that exceed certain thresholds, or steps, above the national benchmark. Thus, the support mechanism is often referred to as a "step function benchmark."

<sup>24</sup> 47 C.F.R. § 36.631(d). The amounts shown in the chart are exclusive of the base 25 percent of loop costs that are recovered in the interstate jurisdiction through access charges.

<sup>25</sup> See 47 C.F.R. § 54.301.

statutory definition of a rural telephone company,<sup>26</sup> support levels for these carriers will remain unchanged pending later proceedings.<sup>27</sup> Carriers that set their access charges through participation in the NECA common-line cost pool, including a few non-rural carriers, also may receive long-term support (LTS), which provides explicit support to reduce these carriers' loop-related access charges.<sup>28</sup>

## 2. Implicit Support

15. In contrast to explicit support, some state rate designs and, to a lesser extent, the federal interstate access charge system, have provided implicit high-cost support flowing from (1) urban areas to rural areas; (2) business customers to residential customers; (3) vertical services to basic service; and/or (4) long distance service to local service. First, many states have adopted the practice of setting uniform local rates throughout the territory that a given company serves within the state, thereby enabling incumbent LECs to charge above-cost rates in urban (low-cost) areas to support the below-cost rates they charge in rural (high-cost) areas. Second, some state regulators have allowed incumbent LECs to charge business customers higher rates than residential customers even though the costs of serving business and residential customers in the same area are roughly the same, thereby creating a business-to-residential support flow. Third, through rate regulation in some states, incumbent LECs are able to charge above-cost rates for vertical services (e.g., touch tone, conference calling, speed dialing, call waiting, caller identification, etc.) in order to support the rates for basic local service. Fourth, incumbent LECs in some states have been able to charge relatively high intrastate access charges to interexchange carriers to cover costs not recovered through local rates. The IXC's pass these access charges on to their long distance customers in the form of higher usage charges for intrastate long distance service, thus creating implicit support from long distance service to local service. Further, the federal interstate access charge system has capped flat end-user rates and recovered certain loop costs through per-minute charges to IXC's, which are being phased out through our access charge reform proceeding.

16. Although implicit universal service support was sustainable in a monopoly environment, it will become more difficult to sustain as competition increases. In a competitive market, a carrier that charges rates significantly above its costs to a class of customers may lose those customers to a competitor charging cost-based rates. As carriers lower their rates closer to their costs in urban areas, or lose low-cost customers to new entrants charging cost-based rates, the implicit support for below-cost rates in high-cost areas may erode. Moreover, efforts to sustain implicit universal service support in a competitive environment could encourage business decisions contrary to the purpose of high-cost support – to enable access to telecommunications service in areas where the cost of such service otherwise would be prohibitively high. For example, competitors may be likely to target

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<sup>26</sup> 47 U.S.C. § 153(37).

<sup>27</sup> See *supra* para. 11.

<sup>28</sup> See 47 U.S.C. § 54.303.

high-revenue business customers in low-cost urban areas where incumbent LECs are charging rates significantly above costs, while foregoing opportunities to serve lower-revenue residential customers in high-cost rural areas where incumbent LECs are charging artificially low rates because of implicit support flows.

## **B. Universal Service Principles Stemming From the 1996 Act**

17. In the 1996 Act, Congress, recognizing that existing universal service support mechanisms were designed for a monopoly environment, directed the Commission to establish support mechanisms for the preservation and advancement of universal service in the competitive telecommunications environment that Congress envisioned.<sup>29</sup> To assist the Commission in preserving and advancing universal service, Congress instructed the Commission to convene a Joint Board for the purpose of making recommendations to the Commission regarding universal service reform.<sup>30</sup>

18. Congress also provided several principles to guide the Commission and the Joint Board in their reform efforts. Specifically, Congress declared that consumers in all regions of the nation, including consumers in rural, insular, and high-cost areas, should have access to telecommunications services at rates that are affordable and reasonably comparable.<sup>31</sup> Congress also stated that federal universal service support mechanisms should, as far as possible, be explicit,<sup>32</sup> as well as specific, predictable, and sufficient to preserve and advance universal service.<sup>33</sup> The support mechanisms also should require all providers of telecommunications services to make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.<sup>34</sup> The support mechanisms should be competitively neutral, i.e., they should neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.<sup>35</sup> Additionally, the support mechanisms should allow any telecommunications carrier, using any

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<sup>29</sup> 47 U.S.C. § 254(b), (d). *See also* Joint Explanatory Statement at 113.

<sup>30</sup> 47 U.S.C. § 254(a)(1).

<sup>31</sup> 47 U.S.C. § 254(b)(1), (3).

<sup>32</sup> 47 U.S.C. § 254(e). *See also* Joint Explanatory Statement at 131 ("To the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today.").

<sup>33</sup> 47 U.S.C. § 254(b)(5).

<sup>34</sup> 47 U.S.C. § 254(b)(4).

<sup>35</sup> Besides the universal service principles specified in the 1996 Act, Congress directed that the Joint Board and the Commission be guided by such other principles they determine to be consistent with the Act, and necessary and appropriate for the protection of the public interest, convenience, and necessity. 47 U.S.C. § 254(b)(7). At the recommendation of the Joint Board, the Commission adopted competitive neutrality as an additional principle for universal service. *First Report and Order*, 12 FCC Rcd at 8801-03, paras. 46-51.

technology, including wireless technology, to receive universal service support if it meets the criteria for eligible telecommunications carrier status under the 1996 Act.<sup>36</sup>

**C. Actions by the Commission and the Joint Board to Reform High-Cost Universal Service Support Pursuant to the 1996 Act**

19. As required by the 1996 Act, the Commission convened the Joint Board,<sup>37</sup> which produced its first set of recommendations to the Commission in November 1996.<sup>38</sup> Based on those recommendations, the Commission adopted the universal service *First Report and Order* in May 1997. Among other things, the Commission identified the services included within the definition of universal service and established a specific timetable for implementation of revised universal service support mechanisms.<sup>39</sup> Consistent with the Joint Board's recommendations, the Commission further concluded that carriers should receive support for serving rural, insular, and high-cost areas based on a methodology using the forward-looking costs of providing supported services. The Commission explained that using forward-looking costs will provide sufficient support without giving carriers an incentive to inflate their costs or to refrain from efficient cost-cutting.<sup>40</sup>

20. To determine the forward-looking costs of providing supported services, the Commission considered various cost models.<sup>41</sup> A cost model consists of: (1) a model platform, which contains a series of fixed assumptions about network design and engineering; and (2) input values for the model platform, such as the cost of network components, e.g., cables and switches, as well as various capital cost parameters.<sup>42</sup> Under the methodology

<sup>36</sup> See 47 U.S.C. § 214(e)(1); *First Report and Order*, 12 FCC Rcd at 8858-59, para. 145.

<sup>37</sup> *Universal Service NPRM*, 11 FCC Rcd 18092.

<sup>38</sup> *Federal-State Joint Board on Universal Service*, Recommended Decision, 12 FCC Rcd 87 (Jt. Bd. 1996) (*First Recommended Decision*).

<sup>39</sup> See *First Report and Order*, 12 FCC Rcd 8776. The Commission designated the following as services eligible for universal service support: (1) single-party service; (2) voice-grade access to the public switched network; (3) Dual Tone Multifrequency signaling or its functional equivalent; (4) access to emergency services including, in some circumstances, access to 911 and Enhanced 911; (5) access to operator services; (6) access to interexchange service; (7) access to directory assistance; and (8) toll limitation services for qualifying low income consumers. *First Report and Order*, 12 FCC Rcd at 8807, para. 56.

<sup>40</sup> *First Report and Order*, 12 FCC Rcd at 8899-8900, paras. 224-26. See also *First Recommended Decision*, 12 FCC Rcd at 232, para. 276.

<sup>41</sup> *First Report and Order*, 12 FCC Rcd at 8903-8917, paras. 232-51. See also *First Recommended Decision*, 12 FCC Rcd at 212-34, para. 237-82.

<sup>42</sup> Because of various deficiencies in the cost models initially presented to the Commission, it did not adopt a specific model platform or set of input values in the *First Report and Order*. *First Report and Order*, 12 FCC Rcd at 8909-10, para. 245. After further consideration of revised cost models, the Commission adopted a

described in the *First Report and Order*, the cost model ultimately selected by the Commission would be used to estimate the forward-looking costs of providing the supported services, but would not, by itself, determine the amount of federal support. Instead, federal support would be based on a methodology comparing the relative differences between the forward-looking costs of providing supported services in a particular area and a national benchmark.

21. In the *First Report and Order*, the Commission, following the Joint Board's recommendation, concluded that its high-cost methodology should compare the forward-looking costs of providing supported services to a national revenue benchmark.<sup>43</sup> The Commission decided that the share of support provided by the federal mechanism initially should be set at 25 percent of the difference between the forward-looking cost of providing supported services and an appropriate revenue benchmark to be determined later.<sup>44</sup> The Commission stated, however, that the federal share of support would be subject to review in light of state proceedings, the development of competition, and other relevant factors.<sup>45</sup> The Commission also determined in the *First Report and Order* that non-rural carriers would begin to receive high-cost support based on forward-looking costs on January 1, 1999.<sup>46</sup> This date subsequently was extended to January 1, 2000.<sup>47</sup> Implementation of support based on forward-looking costs for *rural* carriers, however, would not occur at least until January 1,

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model platform in the *Platform Order* released in October 1998. *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, Fifth Report and Order, 13 FCC Rcd 21323 (1998) (*Platform Order*). As discussed *infra*, the Commission proposed input values in a FNPRM released on May 28, 1999, and adopted final input values in a companion Order today. *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, Further Notice of Proposed Rulemaking, FCC 99-120 (rel. May 28, 1999) (*Inputs Further Notice*); *Inputs Order*, FCC 99-304.

<sup>43</sup> *First Report and Order*, 12 FCC Rcd at 8888, para. 200. See also *First Recommended Decision*, 12 FCC Rcd at 184-85, paras. 184-85.

<sup>44</sup> *First Report and Order*, 12 FCC Rcd at 8888, para. 201. The Commission chose this level of support because 25 percent approximates the cost of providing the supported network facilities that historically have been assigned to the interstate jurisdiction, and 25 percent is the current interstate allocation factor applied to loop costs in the separations process. *First Report and Order*, 12 FCC Rcd at 8888, para. 201, 8925, para. 269.

<sup>45</sup> See *First Report and Order*, 12 FCC Rcd at 8926, paras. 271-72. See also *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd at 11602-09, paras. 219-234 (1998) (*April 1998 Report to Congress*).

<sup>46</sup> *First Report and Order*, 12 FCC Rcd at 8929-30, para. 281.

<sup>47</sup> As discussed *infra*, the implementation date for non-rural carriers initially was extended to July 1, 1999, in conjunction with the referral of issues back to the Joint Board. See *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Order and Order on Reconsideration, 13 FCC Rcd 13749, 13751, para. 4 (1998) (*Referral Order*). The implementation date was later extended to January 1, 2000, in order to allow interested parties to provide further information and verification on certain implementation issues and model input values. *Seventh Report & Order*, 14 FCC Rcd at 8086, para. 19; *Inputs Further Notice*, FCC 99-120 at para. 2.

2001, and only after the Commission selects an appropriate forward-looking mechanism based on recommendations from the Joint Board and a Rural Task Force appointed by the Joint Board.<sup>48</sup>

22. The Commission's decisions in the *First Report and Order* regarding the high-cost support methodology generated significant comment and numerous petitions for reconsideration.<sup>49</sup> In addition, several parties filed petitions for review of the *First Report and Order*, which were consolidated before the United States Court of Appeals for the Fifth Circuit.<sup>50</sup> In the spring of 1998, the state members of the Joint Board requested that certain issues related to the determination of high-cost support be referred back to the Joint Board.<sup>51</sup> In April 1998, the Commission committed itself to completing a proceeding reconsidering the federal share of support before revised support mechanisms are implemented for non-rural carriers,<sup>52</sup> and sought proposals and comments on how to reform high-cost support for non-rural carriers.<sup>53</sup> In response, parties submitted a variety of proposals and comments, and provided input in a series of *en banc* hearings.<sup>54</sup>

23. In July 1998, the Commission referred several issues to the Joint Board for its recommendations.<sup>55</sup> Specifically, the Commission sought recommendations on the following issues: an appropriate methodology for determining support amounts; the extent to which federal universal service support should be applied to the intrastate jurisdiction; whether interstate access charges should be reduced concomitantly to reflect a transition from implicit

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<sup>48</sup> *First Report and Order*, 12 FCC Rcd at 8889, para. 204, 8917-18, paras. 252-56. See also *Rural Task Force Public Notice*, 12 FCC Rcd 15752.

<sup>49</sup> See *April 1998 Report to Congress*, 13 FCC Rcd at 11603-04, paras. 222-23.

<sup>50</sup> See *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999). The court's decision is discussed *infra* in section III.D.

<sup>51</sup> *Formal Request for Referral of Designated Items by the State Members of the § 254 Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 (filed March 11, 1998); Letter from the State Members of the Joint Board to William Kennard, Chairman, FCC, CC Docket No. 96-45 (filed June 18, 1998).

<sup>52</sup> *April 1998 Report to Congress*, 13 FCC Rcd at 11605, para. 224.

<sup>53</sup> *Common Carrier Bureau Seeks Comment on Proposals to Revise the Methodology for Determining Universal Service Support*, Public Notice, 13 FCC Rcd 7341 (Com. Car. Bur. 1998).

<sup>54</sup> In connection with the preparation of the *April 1998 Report to Congress*, the Commission held an *en banc* hearing on March 6, 1998, covering, among other things, revisions to the support methodology for non-rural carriers. On June 8, 1998, the Commission convened an *en banc* hearing, which included the state Joint Board commissioners, to address options for revising the support mechanisms for non-rural carriers. On October 29, 1998, the Commission held an *en banc* hearing, which included the state Joint Board commissioners, to address the consumer billing and information issues that had been referred to the Joint Board.

<sup>55</sup> *Referral Order*, 13 FCC Rcd at 13751-52, para. 6.

to explicit support; how to avoid "windfalls" to carriers if federal funds are applied to the intrastate jurisdiction before states reform intrastate rate structures and support mechanisms; whether and to what extent federal universal service policy should support state efforts to make intrastate support mechanisms explicit; the relationship between the jurisdiction to which funds are applied and the appropriate revenue base upon which the Commission should assess and recover providers' universal service contributions; and to what extent, and in what manner, it is reasonable for providers to recover universal service contributions through rates, surcharges, or other means.<sup>56</sup>

24. In November 1998, the Joint Board released its recommendations on these issues.<sup>57</sup> The *Second Recommended Decision* called for a renewed focus on the statutory principles that sufficient support should be available to ensure that rates are affordable and reasonably comparable.<sup>58</sup> The Joint Board had previously found that rates were generally affordable,<sup>59</sup> and in the *Second Recommended Decision* focused on laying the groundwork for a mechanism to enable reasonably comparable rates.<sup>60</sup> Based on the *Second Recommended Decision*, the Commission released the *Seventh Report and Order* in May 1999.<sup>61</sup> In the *Seventh Report and Order*, the Commission recognized that the 1996 Act requires that rates should be "just, reasonable, and affordable," and that rates in rural, insular, and high-cost areas should be "reasonably comparable" to rates charged for similar services in urban areas.<sup>62</sup> Because the Joint Board had previously determined that rates are generally affordable, the Commission chose to focus more closely on the issue of reasonable comparability of rates in the *Seventh Report and Order*.<sup>63</sup> The Commission adopted the Joint Board's proposal that "reasonably comparable" rates should refer to a "fair range" of rates, requiring support levels sufficient "to prevent pressure from high costs and the development of competition from causing unreasonable increases in rates above current, affordable levels."<sup>64</sup>

25. In the *Seventh Report and Order*, the Commission reconsidered and repudiated the decision in the *First Report and Order* that federal support should be limited to 25 percent

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<sup>56</sup> *Referral Order*, 13 FCC Rcd at 13751-52, para. 6.

<sup>57</sup> *Second Recommended Decision*, 13 FCC Rcd 24744.

<sup>58</sup> *Second Recommended Decision*, 13 FCC Rcd at 24746, para. 3.

<sup>59</sup> *First Recommended Decision*, 12 FCC Rcd at 154, para. 133.

<sup>60</sup> *Second Recommended Decision*, 13 FCC Rcd at 24746, para. 3.

<sup>61</sup> *Seventh Report and Order*, 14 FCC Rcd 8078.

<sup>62</sup> *Seventh Report and Order*, 14 FCC Rcd at 8091-92, para. 29, 8095 para. 36; 47 U.S.C. § 254(b)(1), (3).

<sup>63</sup> *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30.

<sup>64</sup> *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30.

of the difference between the forward-looking cost of providing supported services and a national revenue benchmark.<sup>65</sup> Based on the recommendations of the Joint Board, the Commission concluded that federal support should not be limited to 25 percent because such a limit failed to consider the states' ability to support the costs of providing supported services.<sup>66</sup> The Commission adopted the Joint Board's recommendation to use costs as a proxy for rates in assessing its responsibilities to enable the reasonable comparability of rates. Thus, if federal support is available to cover costs that substantially exceed the national average, no state should face rates that are significantly higher than those elsewhere. The Commission also decided, based on the Joint Board's recommendation, that a cost benchmark would be more appropriate than a revenue benchmark because revenues may not accurately reflect the need for support due to varying rate-setting methods and goals among different states, and because of the administrative difficulties of a revenue approach in light of carriers' decisions to bundle supported services with unsupported services, such as long distance services, wireless services, and Internet access services.<sup>67</sup> Therefore, the Commission adjusted the initial support framework outlined in the *First Report and Order* and established a two-part methodology for non-rural carriers that considers both the relative costs of providing supported services and the states' ability to support those costs using their own resources.<sup>68</sup>

26. In the first step of the methodology described in the *Seventh Report and Order*, the costs incurred by a non-rural carrier to provide supported services are estimated using a model based on forward-looking costs.<sup>69</sup> Those costs are then compared to a national cost benchmark to determine the areas that have costs exceeding the benchmark and are therefore in need of support.<sup>70</sup> In the second step of the methodology,<sup>71</sup> the state's ability to achieve reasonably comparable rates using its own resources would be estimated by multiplying a fixed dollar amount by the number of lines served by non-rural carriers in the state.<sup>72</sup> The federal support mechanism would then provide support for costs that exceed both the national benchmark and the individual state's resources to support those costs.<sup>73</sup> Under this

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<sup>65</sup> *Seventh Report and Order*, 14 FCC Rcd at 8080, para. 3.

<sup>66</sup> *Seventh Report and Order*, 14 FCC Rcd at 8093-94, para. 34, 8105-06, para. 57.

<sup>67</sup> *Seventh Report and Order*, 14 FCC Rcd at 8107-08, paras. 61-62.

<sup>68</sup> *Seventh Report and Order*, 14 FCC Rcd at 8106-10, paras. 58-66.

<sup>69</sup> *Seventh Report and Order*, 14 FCC Rcd at 8106-10, paras. 58-66.

<sup>70</sup> *Seventh Report and Order*, 14 FCC Rcd at 8106-10, paras. 58-66.

<sup>71</sup> As discussed below in section IV.C.4., we have reconsidered and eliminated the second step of the methodology.

<sup>72</sup> *Seventh Report and Order*, 14 FCC Rcd at 8106-10, paras. 58-66.

<sup>73</sup> *Seventh Report and Order*, 14 FCC Rcd at 8106-10, paras. 58-66.



methodology, states would not be required to impose a per-line charge to collect intrastate universal service support, and carriers would not necessarily be entitled to recover a per-line amount from state mechanisms.<sup>74</sup> Instead, the per-line amount would be an estimate of a state's ability to achieve reasonable comparability, and would establish a level above which federal support would be provided.<sup>75</sup>

27. In accordance with the Joint Board's recommendations, the Commission also decided to adopt a hold-harmless provision as part of its new high-cost methodology, i.e., the amount of support provided under the new support mechanism will be no less than the amount provided under the current support mechanism.<sup>76</sup> The hold-harmless provision is intended to prevent potential rate shocks and disruptions in state rate designs when the forward-looking mechanism takes effect.<sup>77</sup> To ensure that support is distributed in a competitively neutral manner, the Commission adopted the Joint Board's recommendation that a portability provision be included in the new high-cost methodology.<sup>78</sup> Under this provision, high-cost support will be made available to all carriers eligible for support,<sup>79</sup> whether they are incumbent LECs, competitive LECs, or wireless carriers.<sup>80</sup> In addition, pending a decision from the Fifth Circuit concerning the Commission's authority to assess carriers' intrastate revenues, the Commission decided that contributions to the high-cost support mechanism should continue to be based on interstate and international revenues.<sup>81</sup> The Commission committed itself to reviewing the operation of the new forward-looking high-cost support mechanism on or before January 1, 2003.<sup>82</sup>

28. Although the Commission adopted a revised framework for the new high-cost support mechanism in the *Seventh Report and Order*, it allowed parties an opportunity for further comment on certain implementation issues in order to create a sufficient record regarding those issues.<sup>83</sup> Specifically, in the further notice section of the *Seventh Report and Order*, the Commission sought comment on the level of the national benchmark; the size of

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<sup>74</sup> *Seventh Report and Order*, 14 FCC Rcd at 8110, para. 65.

<sup>75</sup> *Seventh Report and Order*, 14 FCC Rcd at 8110, para. 65.

<sup>76</sup> *Seventh Report and Order*, 14 FCC Rcd at 8111, para. 68.

<sup>77</sup> *Seventh Report and Order*, 14 FCC Rcd at 8111, para. 68.

<sup>78</sup> *Seventh Report and Order*, 14 FCC Rcd at 8112-13, paras. 71-72.

<sup>79</sup> See 47 U.S.C. § 214(e).

<sup>80</sup> *Seventh Report and Order*, 14 FCC Rcd at 8113, para. 72.

<sup>81</sup> *Seventh Report and Order*, 14 FCC Rcd at 8122, para. 90.

<sup>82</sup> *Seventh Report and Order*, 14 FCC Rcd at 8123-24, paras. 93-94.

<sup>83</sup> *Seventh Report and Order*, 14 FCC Rcd at 8124, para. 95.

the area over which costs should be averaged; the estimate of a state's ability to support high-cost areas; methods for ensuring that support is distributed and applied consistent with the 1996 Act; and the implementation of the hold-harmless and portability provisions.<sup>84</sup> At the same time the Commission released the *Seventh Report and Order*, the Commission also released the *Inputs Further Notice* seeking comment on proposed input values for the cost model.<sup>85</sup>

#### D. Opinion of the Fifth Circuit Court of Appeals

29. On July 30, 1999, a three-judge panel of the Fifth Circuit issued its opinion in *Texas Office of Public Utility Counsel v. FCC*, affirming in part, reversing in part, and remanding in part the *First Report and Order*.<sup>86</sup> Among other things, the court rejected challenges by several incumbent LECs to the use of a forward-looking cost model for determining high-cost support for non-rural carriers. The court concluded that the Commission could reasonably interpret section 254 of the 1996 Act to authorize a cost model methodology.<sup>87</sup> Specifically, the court held:<sup>88</sup>

[T]he FCC's reason for adopting this methodology is not just to preserve universal service. Rather it is also trying to encourage local competition by setting the cost models at the "most efficient" level so that carriers will have the incentive to improve operations. As long as it can reasonably argue that the methodology will provide sufficient support for universal service, however, it is free, under the deference we afford it under *Chevron [USA, Inc. v. National Resources Defense Council, Inc., 467 U.S. 837 (1984)]* step-two, to adopt a methodology that serves its other goal of encouraging local competition.

The court also accepted the Commission's argument that "sufficient" support does not mean

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<sup>84</sup> *Seventh Report and Order*, 14 FCC Rcd at 8124-36, paras. 96-122. To supplement the record in the ongoing companion access charge reform proceeding, the Commission also sought comment in the *Seventh Report and Order* on how interstate access charges should be adjusted to account for implicit high-cost universal service support that may, in the future, be identified in access rates. *Seventh Report and Order*, 14 FCC Rcd at 8136-41, paras. 123-35. As discussed in section IV.H., *infra*, comments in response to the questions raised about interstate access charges will be addressed in the ongoing access charge reform proceeding rather than the instant universal service proceeding. See *Access Charge Reform Order*, 12 FCC Rcd 15982.

<sup>85</sup> *Inputs Further Notice*, FCC 99-120.

<sup>86</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 449.

<sup>87</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 411.

<sup>88</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 412.

that the amount of support provided must equal the costs reflected in carriers' books.<sup>89</sup>

30. Concerning the assessment base for contributions to the universal service support mechanisms, the court found that the Commission lacked jurisdiction to assess the intrastate revenues of universal service contributors.<sup>90</sup> The court also reversed and remanded for further consideration the Commission's decision to assess contributions based on the international revenues of contributors having interstate revenues.<sup>91</sup> In addition, the court reversed the Commission's "decision to require ILECs to recover universal service contributions from their interstate access charges."<sup>92</sup> The court held that this requirement maintained an implicit subsidy in violation of section 254(e) of the Act.<sup>93</sup>

#### E. Response to the Fifth Circuit's Opinion

31. On September 9, 1999, the Commission filed a motion for stay of the Fifth Circuit's mandate in *Texas Office of Public Utility Counsel v. FCC*, which was to become effective on September 20, 1999.<sup>94</sup> On September 13, 1999, the Commission, GTE, and AT&T each filed petitions for rehearing with the Fifth Circuit.<sup>95</sup> On September 28, 1999, the Fifth Circuit denied all of the petitions for rehearing, and granted the Commission's motion for stay in part.<sup>96</sup> The Fifth Circuit stayed its mandate until November 1, 1999.<sup>97</sup>

32. In response to the court's rulings, the Commission adopted an Order on

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<sup>89</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 412.

<sup>90</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 446-48.

<sup>91</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 433-35.

<sup>92</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 425.

<sup>93</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 425.

<sup>94</sup> Commission's Motion for a Stay of the Mandate (filed Sept. 9, 1999).

<sup>95</sup> FCC Petition for Panel Rehearing (filed Sept. 13, 1999); FCC Petition for Rehearing *En Banc* (filed Sept. 13, 1999); Petition for Rehearing of the GTE Entities (filed Sept. 13, 1999); Petition for Rehearing *En Banc* of the GTE Entities (filed Sept. 13, 1999); Petition of Intervenor AT&T Corp. for Rehearing *En Banc* (filed Sept. 13, 1999).

<sup>96</sup> *Texas Office of Public Utility Counsel v. FCC*, No. 97-60421, (Sept. 28, 1999) (Order denying petitions for rehearing); *Texas Office of Public Utility Counsel v. FCC*, No. 97-60421, (Sept. 28, 1999) (Order granting motion for stay in part).

<sup>97</sup> *Texas Office of Public Utility Counsel v. FCC*, No. 97-60421, (Sept. 28, 1999) (Order granting motion for stay in part).

October 8, 1999, that amends its contribution and recovery rules, effective November 1, 1999.<sup>98</sup> Specifically, the Commission removed intrastate revenues from the contribution base, so that universal service contributions are now calculated using a single contribution factor based on interstate and international end-user telecommunications revenues.<sup>99</sup> The Commission also exempted from the contribution base the international revenues of interstate carriers whose interstate revenues account for less than 8 percent of their combined interstate and international revenues.<sup>100</sup> Further, the Commission revised its rules to comply with the court's directive that our rules not require implicit support flows. The new rules allow incumbent LECs to recover their contributions through access charges or through end-user charges.<sup>101</sup> To the extent they choose to implement an interstate end-user charge, incumbent LECs that are currently recovering their universal service contributions in interstate access charges must make corresponding reductions in their interstate access charges to avoid any double recovery.<sup>102</sup>

33. In light of the Fifth's Circuit's decision and the Commission's response to it, the present Order adjusts the methodology described in the *Seventh Report and Order*, resolves the remaining implementation issues, and adopts a final forward-looking high-cost support methodology. In the companion *Inputs Order* adopted today, the Commission resolves the issues raised in the *Inputs Further Notice* and adopts final input values for the cost model.<sup>103</sup> With the adoption of these two Orders, the Commission's new forward-looking high-cost support mechanism is now ready to begin providing support to non-rural carriers effective January 1, 2000.

#### IV. ORDER

##### A. Introduction

34. In this Order, we adopt a new specific and predictable forward-looking mechanism that will provide sufficient support to enable affordable, reasonably comparable

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<sup>98</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Access Charge Reform*, CC Docket No. 96-262, Sixteenth Order on Reconsideration in CC Docket No. 96-45, Eighth Report and Order in CC Docket No. 96-45, Sixth Report and Order in CC Docket No. 96-262, FCC 99-290 (rel. Oct. 8, 1999) (*Universal Service Remand Order*).

<sup>99</sup> *Universal Service Remand Order*, FCC 99-290 at paras. 15, 17.

<sup>100</sup> *Universal Service Remand Order*, FCC 99-290 at paras. 15, 19-29.

<sup>101</sup> *Universal Service Remand Order*, FCC 99-290 at paras. 30-33.

<sup>102</sup> *Universal Service Remand Order*, FCC 99-290 at para 33.

<sup>103</sup> *Inputs Order*, FCC 99-304.

intrastate rates for customers served by non-rural carriers.<sup>104</sup> The methodology for this mechanism is based on the framework outlined in the *Seventh Report and Order*, with certain modifications discussed below. Specifically, the forward-looking mechanism compares the costs of providing supported services in a particular state, as determined by the cost model, to a national benchmark, and provides support for costs that exceed that benchmark. In constructing this mechanism, we begin by examining the appropriate federal and state roles in providing universal service support for intrastate rates. Next, we address specific methodological issues relating to the calculation of forward-looking support, including the area over which costs should be averaged; the level of the national benchmark; the amount of support to be provided for costs above the national benchmark; the elimination of the state share requirement; and the targeting of the statewide support amount. We then address the hold-harmless and portability provisions, and the methods to ensure that non-rural carriers use support in compliance with the 1996 Act. We next address the assessment and recovery bases for contributions to the high-cost support mechanism. We also describe our plan to address implicit support in access charges as part of our separate *Access Charge Reform* proceeding. In addition, we modify the rules governing our existing support mechanism to ensure that support for rural carriers is not substantially changed when non-rural carriers are removed from that mechanism and transitioned to the new forward-looking support mechanism. Finally, we lift the stay on our section 251 pricing rules, effective May 1, 2000. We emphasize that there may be several ways in which we could design the various components of the federal support mechanism consistent with section 254, but we believe, in light of the facts before us and in consultation with the Joint Board, that the method we adopt here appropriately balances the varied and competing goals of section 254.

35. The new forward-looking support mechanism that we adopt today will provide forward-looking support effective January 1, 2000. As discussed below in section IV.F., however, the actual disbursement of forward-looking support (retroactive to January 1, 2000) will not occur until the second quarter of 2000. Moreover, no commenter has claimed that implementation of the new forward-looking mechanism presents any "Y2K" problems. Thus, we do not foresee any "Y2K" issues associated with the transition to the new forward-looking mechanism because there will be no actual change in support levels on or around January 1, 2000.<sup>105</sup>

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<sup>104</sup> See 47 U.S.C. § 254(b)(3), (5). We intend to address reform of universal service support in interstate access rates in our ongoing access charge reform proceeding. See *Access Charge Reform Order*, 12 FCC Rcd 15982. In section IV.C.3., *infra*, we specifically account for carriers' bifurcated recovery of costs in the two jurisdictions to ensure that our actions here do not disrupt our jurisdictional separations rules. See 47 C.F.R. Part 31.

<sup>105</sup> In the event that a carrier presents a serious and unanticipated Y2K-related implementation problem to the Commission before January 1, 2000, we will consider the issue expeditiously. See *Minimizing Regulatory and Information Technology Requirements that Could Adversely Affect Progress Fixing the Year 2000 Date Conversion Problem*, Year 2000 Network Stabilization Policy Statement, FCC 99-272 (rel. Oct. 4, 1999). We discourage parties dissatisfied with the policies adopted in this Order from using Y2K as an excuse to delay implementation of the new forward-looking support mechanism.

## **B. Federal and State Roles in Providing Universal Service Support for Intrastate Rates**

36. To construct an appropriate methodology for providing federal high-cost support, we must first examine the respective roles of federal and state regulators in providing such support. Historically, federal programs have provided explicit intrastate high-cost support for local loop and switching costs that significantly exceeded the national average.<sup>106</sup> Many state programs, on the other hand, have largely achieved the goals of intrastate universal service implicitly through rate structures and, to a lesser extent, through explicit state high-cost support mechanisms. As discussed above, many state rate structures have included significant implicit support for universal service.<sup>107</sup> The states' historical authority over intrastate ratemaking, and thus their primary responsibility for intrastate universal service, has been recognized by the Commission.<sup>108</sup> The Commission, however, has had a longstanding goal of promoting universal service nationwide, and thus has provided support for intrastate-allocated costs that significantly exceed the national average.

37. In *Texas Office of Public Utility Counsel v. FCC*, the Fifth Circuit held that section 254 of the Act did not affect the proscription, set forth in section 2(b), against Commission regulation of intrastate rates.<sup>109</sup> Thus, states alone have jurisdiction for setting rates for intrastate services. Consequently, states alone have the authority to set rates for intrastate services that are just, reasonable, affordable, and reasonably comparable. We conclude that Congress would not have imposed on the Commission obligations regarding intrastate rates that the Commission does not have the legal authority to effectuate. Indeed, the Fifth Circuit found that the Commission was permitted (but not required) to provide federal universal service support for intrastate services.<sup>110</sup> The Fifth Circuit also found that the Commission may condition such support on assurances by states that such federal support will be used for its intended purposes.<sup>111</sup>

38. In the *Second Recommended Decision*, the Joint Board recognized that section

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<sup>106</sup> Under the Commission's rules, only certain small carriers are eligible to receive support for switching costs. See 47 C.F.R. §§ 54.201, 54.301.

<sup>107</sup> See *supra* section III.A.2.

<sup>108</sup> See, e.g., *First Report and Order*, 12 FCC Rcd at 8926, para. 271 ("The Commission does not have any authority over the local rate setting process or the implicit intrastate universal service support reflected in intrastate rates.").

<sup>109</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 421, 424, 446-48. Although the Commission disagrees with the court's jurisdictional analysis, this Order is consistent with the court's decision.

<sup>110</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 444.

<sup>111</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 444.

254 does not alter the states' historical responsibility for intrastate universal service.<sup>112</sup> The Joint Board interpreted section 254(b)(3)'s principle that rates be "reasonably comparable" to refer to "a fair range of urban/rural rates both within a state's borders, and among states nationwide."<sup>113</sup> The Joint Board found that the federal role in achieving reasonably comparable rates should be to provide "those amounts necessary to establish a standard of reasonable comparability of rates across states."<sup>114</sup> According to the Joint Board, the state role is to "supplement, as desired, any amount of federal funds it may receive," and to "address issues regarding implicit intrastate support in a manner that is appropriate to local conditions."<sup>115</sup> Stated another way, the primary federal role is to enable reasonable comparability among states (i.e., to provide states with sufficient support so that states can make local rates reasonably comparable among states), and the primary role of each state is to ensure reasonable comparability within its borders (i.e., to apply state and federal support to make local rates reasonably comparable within the state). This Order adopts that approach as a policy goal. In addition, the approach is consistent with the Fifth Circuit's decision regarding the Commission's responsibility for supporting intrastate services. It also is consistent with Congress's goal of making universal service support explicit.

### C. New Forward-Looking High-Cost Support Methodology

39. This Order sets out a methodology – in essence, a set of formulas – that will be used to determine non-rural carriers' support amounts for serving rural and high-cost areas. The methodology computes a specific support amount, and can be replicated by carriers or other members of the public. The methodology will change over time only in the ways we specifically describe herein or pursuant to modifications that we make in the future pursuant to public notice and comment in this proceeding. Thus, the methodology is specific and predictable.<sup>116</sup> Moreover, for the reasons discussed below, we find that this mechanism will result in sufficient support to enable affordable and reasonably comparable rates for customers in areas served by non-rural carriers.<sup>117</sup>

40. In the *First Report and Order*, the Commission concluded that high-cost support should be based on forward-looking costs.<sup>118</sup> Since that time, the Commission has

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<sup>112</sup> *Second Recommended Decision*, 13 FCC Rcd at 24747, para. 6, 24755-56, paras. 24-26.

<sup>113</sup> *Second Recommended Decision*, 13 FCC Rcd at 24754, para. 18.

<sup>114</sup> *Second Recommended Decision*, 13 FCC Rcd at 24760, para. 37.

<sup>115</sup> *Second Recommended Decision*, 13 FCC Rcd at 24760, paras. 37, 39.

<sup>116</sup> See 47 U.S.C. § 254(b)(5), (d).

<sup>117</sup> See 47 U.S.C. § 254(b)(3), (d).

<sup>118</sup> *First Report and Order*, 12 FCC Rcd at 8899-8900, paras. 224-226.

continued to work to adopt a cost model that is reasonably accurate and verifiable.<sup>119</sup> As an initial matter, we note that in the *Inputs Order* we have affirmed the Commission's decision to base support calculations on forward-looking costs.<sup>120</sup> Moreover, the Commission and its staff have undertaken a thorough review of the model and its input values over the past six months. In so doing, the staff has coordinated extensively with, and received substantial input from, the Joint Board staff and interested outside parties. As a result of this examination of the model, we have concluded in the *Inputs Order* that the model generates reasonably accurate estimates of forward-looking costs and that the model is the best basis for determining non-rural carriers' high-cost support in a competitive environment.<sup>121</sup> We have found that none of the criticisms of the model undermine our decision to use it for calculating non-rural carriers' high-cost support.<sup>122</sup> As discussed in the *Inputs Order*, we believe that using the model is the best way to determine non-rural carriers' support amounts for the funding year beginning January 1, 2000.<sup>123</sup> We also recognize, however, that the model must evolve as technology and other conditions change. We therefore have committed in the *Inputs Order* to initiating a proceeding to study how the model should be used in the future and how the model itself should change to reflect changing circumstances.<sup>124</sup>

41. Finally, as discussed further in the *Inputs Order*, we reiterate that the federal cost model was developed for the purpose of determining federal universal service support, and that it may not be appropriate to use nationwide values for other purposes, such as determining prices for unbundled network elements.<sup>125</sup> The Commission has not considered the appropriateness of this model for any other purposes, and we have cautioned parties from making any claims in other proceedings based upon the input values adopted in the *Inputs*

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<sup>119</sup> See, e.g., *Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, *Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs*, 97-160, Further Notice of Proposed Rulemaking, 12 FCC Rcd 18514 (1997) (1997 Further Notice); *Common Carrier Bureau Requests Further Comment on Selected Issues Regarding the Forward-Looking Economic Cost Mechanism for Universal Service*, CC Docket Nos. 96-45, 97-160, Public Notice, DA 98-848 (rel. May 4, 1998) (*Inputs Public Notice*); *Common Carrier Bureau to Hold Three Workshops on Input Values to be Used to Estimate Forward-Looking Economic Costs for Purposes of Universal Service Support*, CC Docket Nos. 96-45, 97-160, Public Notice, DA 98-2406 (rel. Nov. 25, 1998) (*Workshop Public Notice*); *Inputs Further Notice*, FCC 99-120.

<sup>120</sup> *Inputs Order*, FCC 99-304 at para. 22.

<sup>121</sup> *Inputs Order*, FCC 99-304 at para. 23.

<sup>122</sup> *Inputs Order*, FCC 99-304 at para. 24.

<sup>123</sup> *Inputs Order*, FCC 99-304 at para. 28.

<sup>124</sup> *Inputs Order*, FCC 99-304 at para. 28.

<sup>125</sup> *Inputs Order*, FCC 99-304 at para. 32. State commissions, for example, may find that it is not appropriate to use nationwide values in determining state universal service support or prices for unbundled network elements and may choose instead to use statewide or company-specific values.



*Order.*<sup>126</sup>

42. Consistent with the goals of federal universal service support discussed above, the new forward-looking support mechanism will compare the average costs of providing supported services in a given area to the national benchmark, provide support for costs exceeding the national benchmark, and then target that support based on wire-center costs, so that the amount of support available to a competitor depends on the cost level of the wire center. In this section, we examine the area over which costs should be averaged; the level of the national benchmark; the amount of support to be provided for costs above the national benchmark; the elimination of the state share requirement; and the method for targeting statewide support amounts.

## 1. Area Over Which Costs Should Be Averaged

### a. Background

43. In the *Second Recommended Decision*, the Joint Board weighed several options for the area over which costs should be averaged.<sup>127</sup> Recognizing that states have a substantial role in preserving universal service and "can be expected to participate as full partners" with the Commission, the Joint Board considered the use of statewide average costs to determine the need for universal service support.<sup>128</sup> The Joint Board observed that statewide averaging could require some states to create mechanisms to transfer support among non-rural carriers in different study areas.<sup>129</sup> Because the Joint Board believed that the short lead time before implementation of the new forward-looking mechanism would not be sufficient for some states to create such mechanisms, it declined to recommend a statewide approach.<sup>130</sup> Instead, the Joint Board recommended that costs be averaged at the study area level.<sup>131</sup> Although the Joint Board recognized that determining costs at the wire center level allows for a more granular measure of support, it concluded that, as between the study area and wire center approaches, the study area approach would "properly measure the support responsibility that ought to be borne by the federal mechanism given the current extent of local competition."<sup>132</sup>

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<sup>126</sup> *Inputs Order*, FCC 99-304 at para. 32.

<sup>127</sup> *Second Recommended Decision*, 13 FCC Rcd at 24758-59, paras. 32-35.

<sup>128</sup> *Second Recommended Decision*, 13 FCC Rcd at 24759, para. 35.

<sup>129</sup> *Second Recommended Decision*, 13 FCC Rcd at 24759, para. 35.

<sup>130</sup> *Second Recommended Decision*, 13 FCC Rcd at 24759, para. 35.

<sup>131</sup> *Second Recommended Decision*, 13 FCC Rcd at 24759, paras. 33, 35.

<sup>132</sup> *Second Recommended Decision*, 13 FCC Rcd at 24759, para. 33. As discussed *infra*, the Commission believes that the appropriate federal role in providing support for intrastate rates, rather than the current level of competition, should be the driving factor in the selection of the appropriate area over which costs should be

44. Instead of adopting a particular approach in the *Seventh Report and Order*, the Commission sought comment on the appropriate area over which costs should be averaged.<sup>133</sup> Specifically, the Commission asked commenters to consider the wire center level, the unbundled network element (UNE) cost zone level, and the study area level.<sup>134</sup> The Commission also described the perceived benefits and drawbacks of each of those approaches.<sup>135</sup>

#### b. Discussion

45. *Federal and State Roles.* After further consultation with the Joint Board, we believe that the federal mechanism should calculate support levels for non-rural carriers by comparing the forward-looking costs of providing supported services, averaged at the statewide level, to the national benchmark.<sup>136</sup> Of all the potential approaches suggested,<sup>137</sup> we believe that statewide averaging is the approach most consistent with the federal role of providing support for intrastate universal service to enable reasonable comparability of rates among states. Federal high-cost support is generated through contributions by all interstate telecommunications carriers for purposes of providing support to high-cost states. This has the effect of shifting money from relatively low-cost states to relatively high-cost states. By averaging costs at the statewide level, the federal mechanism compares the relative costs of providing supported services in different states. The federal mechanism will then provide support to carriers in those states with costs that exceed the national average by a certain amount, i.e., the national benchmark (135 percent of the national average).<sup>138</sup> This approach ensures that no state with costs greater than the national benchmark will be forced to keep rates reasonably comparable without the benefit of federal support. By averaging costs at the statewide level, the federal mechanism is designed to achieve reasonable comparability of

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averaged.

<sup>133</sup> *Seventh Report and Order*, 14 FCC Rcd at 8126-30, paras. 101-109.

<sup>134</sup> *Seventh Report and Order*, 14 FCC Rcd at 8126-27, para. 102.

<sup>135</sup> *Seventh Report and Order*, 14 FCC Rcd at 8127-30, paras. 103-109.

<sup>136</sup> Because we are, in this phase of this proceeding, considering universal service reform only for non-rural carriers, when we speak of "statewide" averaged costs, we are referring only to the entire area within a state that is served by non-rural carriers. Moreover, our decision to adopt a statewide averaging approach for non-rural carriers does not necessarily mean that we will adopt a similar approach for rural carriers in the future.

<sup>137</sup> We recognize that the Commission did not specifically ask for comment on the statewide averaging approach in the *Seventh Report and Order*. Considering that the Joint Board addressed the statewide approach in its *Second Recommended Decision*, and that the Commission was seeking comment on the appropriate area over which costs should be averaged, we believe that the decision to adopt a statewide approach is a logical outgrowth of the proposal to average costs over a given area. See *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506 (D.C. Cir. 1983).

<sup>138</sup> The national benchmark is discussed *infra* in section IV.C.2.

intrastate rates among states based solely on the interstate transfer of funds.

46. The states, in contrast, have the primary responsibility for ensuring reasonable comparability of rates within their borders. The federal mechanism leaves this state role intact, but provides support to carriers in states with average costs substantially in excess of the national average. With the elimination of the state share requirement,<sup>139</sup> no state resources are relied upon by the federal mechanism in providing support for costs above the benchmark. This permits the states to use their substantial resources to achieve the goal of reasonably comparable rates within states. In many cases, states have brought their resources to bear through rate averaging and other forms of implicit support. Recently, some states have created explicit support mechanisms.<sup>140</sup> We recognized the states' jurisdiction over intrastate support in the *Seventh Report & Order*, when we observed that "the erosion of intrastate implicit support does not mean that federal support must be provided to replace [it]. Indeed, it would be unfair to expect the federal support mechanism, which by its very nature operates by transferring funds among jurisdictions, to bear the support burden that has historically been borne within a state by intrastate, implicit support mechanisms."<sup>141</sup> Thus, we believe that statewide averaging, together with the rest of the methodology we adopt today, is consistent with the division of federal and state responsibility for achieving reasonable comparability for non-rural carriers.

47. *Joint Board.* We also find that averaging costs at the statewide level is consistent with the Joint Board's vision for the scope and purpose of the federal high-cost support mechanism. The Joint Board noted that this Commission alone has the ability to implement a support mechanism that transfers support from one state to another,<sup>142</sup> and stated that federal support should be provided to achieve reasonably comparable rates across states.<sup>143</sup> The Joint Board envisioned that the states should have the primary responsibility for ensuring reasonable comparability within states.<sup>144</sup> Although the Joint Board recommended averaging costs at the study area level instead of the statewide level, it did so based on its concern that there would be insufficient time before implementation of the new federal mechanism for some states to adopt the necessary mechanisms to transfer support among non-rural carriers in

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<sup>139</sup> See *infra* section IV.C.4.

<sup>140</sup> While the 1996 Act does not require states to establish explicit intrastate universal service support mechanisms, the Joint Board has acknowledged that the competitive forces that prompted Congress to favor explicit federal support mechanisms may also lead states to establish explicit state support mechanisms. *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 26.

<sup>141</sup> *Seventh Report & Order*, 14 FCC Rcd at 8101, para. 46. See AT&T reply comments at 6 (the federal mechanism should focus on support flows among states, rather than within states).

<sup>142</sup> *Second Recommended Decision*, 13 FCC Rcd at 24752-53, para. 14.

<sup>143</sup> *Second Recommended Decision*, 13 FCC Rcd at 24760, para. 37.

<sup>144</sup> *Second Recommended Decision*, 13 FCC Rcd at 24760, paras. 38-39.

different study areas within a particular state.<sup>145</sup> The carrier-by-carrier interim hold-harmless approach that we adopt today, however, alleviates the Joint Board's concern.<sup>146</sup> Under that approach, each non-rural carrier within a state will receive no less support under the new mechanism than it receives under the current mechanism. Because the carrier-by-carrier interim hold-harmless approach will be in effect for up to three years from implementation of the new forward-looking mechanism, states have no immediate need to transfer support among study areas within their borders.<sup>147</sup> In addition, states should have ample time to implement whatever state mechanisms are necessary to achieve such transfers before the Commission reviews the need for a hold-harmless provision. Therefore, the only impediment to statewide averaging identified by the Joint Board – lack of sufficient time for state action – has been removed by the carrier-by-carrier interim hold-harmless provision.

48. *Alternative Approaches.* We have carefully reviewed the alternatives to statewide averaging, and in the context of non-rural carriers, in light of the overall methodology we adopt here and the specific circumstances before us, we conclude that statewide averaging is the best approach to further the goals of section 254, while respecting the historical federal and state roles for universal service. There are several benefits to statewide averaging. Statewide averaging considers costs averaged with regard to state boundaries, thereby taking into consideration each state's authority and ability to achieve reasonable comparability of rates within its borders. We recognize that averaging at the study area, UNE cost zone, or wire center levels would have the advantage of providing a more granular measure of support, and that granularity of support is a desirable goal in a competitive marketplace.<sup>148</sup> Given the specific circumstances and purposes we address here, however, we believe that statewide averaging, coupled with our decision to target the distribution of support to wire centers with the highest costs in a state, better balances the goal of targeting support to high-cost areas against the recognition that states can and should satisfy their own rate comparability needs to the extent possible before drawing support from other states.

49. For example, assume that the Commission chose to average costs at the wire

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<sup>145</sup> *Second Recommended Decision*, 13 FCC Rcd at 24759, para. 35.

<sup>146</sup> The carrier-by-carrier hold-harmless approach is discussed in section IV.D., *infra*.

<sup>147</sup> In the *Seventh Report and Order*, the Commission stated that it would review the operation of the new federal mechanism, including the hold-harmless provision, on or before January 1, 2003. *Seventh Report and Order*, 14 FCC Rcd at 8123-24, para. 94. In this Order, we have asked the Joint Board to provide us with its recommendations, on or before July 1, 2000, regarding how the interim hold-harmless provision may be phased out without causing undue disruption to consumer rates in high-cost areas. See *infra* section IV.D.

<sup>148</sup> The results from these sub-statewide approaches can be tabulated into state categories to determine the amount of support provided to a particular state, but the averaging occurs independent of state boundaries.

center level.<sup>149</sup> Under this approach, the costs of providing supported services in individual wire centers would be averaged together to arrive at a national average cost per wire center. Wire centers with costs that exceed the national benchmark would receive support. Because the costs in high-cost wire centers in a given state would not be averaged first with lower-cost wire centers in the same state, wire center averaging would ignore the state's authority and ability to ensure reasonable comparability of rates within its borders. Stated another way, the federal mechanism would shift funds from low-cost wire centers (and customers) in other states to fund high-cost wire centers in the state at issue, and would do so without giving the state the opportunity to support its high-cost wire centers with funds from its low-cost wire centers.

50. The same issue arises if costs are averaged at the UNE cost zone level.<sup>150</sup> Pursuant to our UNE cost zone rules, state commissions must set different rates for elements in at least three defined geographical areas within the state to reflect geographic cost differences, and may employ existing density-related zone pricing plans or other cost-related zone plans established pursuant to state law.<sup>151</sup> Under a UNE cost zone approach to averaging forward-looking costs, costs in individual UNE cost zones would be averaged together to arrive at a national average cost per UNE cost zone. UNE cost zones with costs greater than the benchmark would receive support. As in the wire center approach, the federal mechanism would provide support to high-cost UNE cost zones in a state, without regard to the state's authority or ability to ensure reasonable comparability of rates within its borders. In providing such support, the federal mechanism would shift funds from low-cost UNE zones in other states to high-cost UNE zones in the subject state, thus saddling ratepayers in other states with burdens more appropriately placed on ratepayers in the subject state. Additionally, although we expressed concern in the *Seventh Report and Order* that averaging costs over an area larger than the UNE cost zone could result in opportunities for arbitrage or other uneconomic activities, our concern was based on the assumption that all lines within that larger geographic area would be eligible for the same amount of support, even though UNE prices would differ among UNE zones.<sup>152</sup> Because the new federal mechanism calculates the amount of support at the statewide level, but targets that support to high-cost wire centers

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<sup>149</sup> Several commenters support averaging costs at the wire center level. See PCIA comments at 3; PRTC comments at 5; SBC comments at 3; Western Wireless comments at 3; USCC reply comments at 7.

<sup>150</sup> Some commenters support averaging costs at the UNE cost zone level. See BellSouth comments at 6; GTE comments at 23; USTA comments at 6.

<sup>151</sup> *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 (1996), *aff'd in part and vacated in part sub nom. Iowa Utilities Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utilities Bd.*, 119 S.Ct. 721 (1999) (*Local Competition Order*). See *infra* section IV.J., regarding the reinstatement of our UNE deaveraging rules following the Supreme Court's decision in that matter.

<sup>152</sup> *Seventh Report and Order*, 14 FCC Rcd at 8128-29, para. 106.

within the state,<sup>153</sup> all lines within a state are not eligible for the same amount of support. Thus, the potential for arbitrage or other uneconomic activity is reduced.<sup>154</sup>

51. Study area cost averaging suffers from the same infirmities as wire center or UNE cost zone averaging.<sup>155</sup> In many states, only one non-rural carrier provides service. In such states, the state boundary and the study area boundary are the same. Some states, however, possess more than one non-rural carrier, and thus more than one study area.<sup>156</sup> Thus, under a study area averaging approach, costs in individual study areas would be averaged together to arrive at a national average cost per study area. Study areas with costs greater than the benchmark would receive support. The federal mechanism, therefore, would shift funds from low-cost study areas in one state to high-cost study areas in another state without regard to the recipient state's authority or ability to provide support for costs within its borders. In addition, such a federal mechanism could provide greater support to a state with more than one study area than it would to a state with a single study area, even though both states have the same average forward-looking costs on a statewide level, thus discriminating against a state that has only one non-rural study area. For example, assume that a state with a single study area has average costs below the benchmark and therefore does not receive forward-looking support. Assume that another state has the same average statewide costs below the benchmark, but has two study areas, one with costs above the benchmark and one with costs below the benchmark. Under a study area averaging approach, the federal mechanism would provide support for the high-cost study area even though the statewide average cost is below the benchmark. This result would burden the federal support mechanism (and thus all ratepayers) with providing support for a state that, through happenstance, has more than one non-rural carrier, and therefore more than one study area. Such support should instead be provided by the state in its role as the primary ratemaking authority and provider of support within its borders.

52. Several commenters have suggested nonetheless that a decision by the Commission to average costs over a large geographic area is merely an arbitrary way to restrain the size of the fund created by the new forward-looking support mechanism.<sup>157</sup> We reject this assertion. Congress stated that the Commission shall establish specific, predictable,

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<sup>153</sup> See *infra* section IV.C.5.

<sup>154</sup> See West Virginia comments at 8.

<sup>155</sup> The majority of commenters support study area averaging. See AT&T comments at 12-13; Bell Atlantic comments at 5-6; California comments at 9-12; CBT comments at 4; CompTel comments at 3; Vermont comments at 15; West Virginia comments at 4.

<sup>156</sup> The following states have more than one non-rural study area: Alabama (3); California (4); Florida (3); Illinois (3); Indiana (3); Kentucky (3); Michigan (2); Minnesota (2); Missouri (3); North Carolina (6); Nebraska (2); Nevada (2); New York (2); Ohio (4); Oklahoma (2); Oregon (2); Pennsylvania (2); South Carolina (2); Tennessee (2); Texas (4); Virginia (4); Washington (2); and Wisconsin (2).

<sup>157</sup> See, e.g., BellSouth comments at 7-8; GSA reply comments at 4; US West reply comments at 1-2.

and *sufficient* mechanisms to preserve and advance universal service.<sup>158</sup> Moreover, the Fifth Circuit approved the Commission's use of a methodology based on forward-looking cost models for this task "[a]s long as [the Commission] can reasonably argue that the methodology will provide sufficient support for universal service . . . ."<sup>159</sup> Thus, despite our general agreement with the Joint Board's conclusion that the federal fund should not increase substantially at this time,<sup>160</sup> our primary goal in this proceeding must be to provide sufficient universal service support to enable reasonable comparability of rates among states.<sup>161</sup> We meet this policy goal, however, in a manner consistent with the federal role for providing universal service support, which, as discussed above, we find to be transferring funds among states.<sup>162</sup> Accordingly, we conclude that statewide averaging of forward-looking costs is the appropriate means for achieving the federal mechanism's primary goal of enabling reasonable comparability of rates among states.

## 2. National Benchmark

### a. Background

53. In the *Second Recommended Decision*, the Joint Board recommended that the Commission consider a national benchmark in the range between 115 and 150 percent of the national average cost per line.<sup>163</sup> While most commenters supported the use of a national benchmark, many were reluctant to comment on the Joint Board's recommendation in the absence of a more finalized cost model. Therefore, we sought further comment in the *Seventh Report and Order* on the Joint Board's recommended range and urged commenters to formulate their comments using the updated cost model outputs available as a result of the

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<sup>158</sup> 47 U.S.C. § 254(d).

<sup>159</sup> *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 412.

<sup>160</sup> *Seventh Report and Order*, 14 FCC Rcd at 8129-30, para. 109. See *infra* section IV.C.3.

<sup>161</sup> See Iowa comments at 3; US West comments at 22; GTE reply comments at 8. We recognize that section 254 also states that federal support should be specific and predictable. 47 U.S.C. § 254 (b)(5), (d). We believe, however, that the forward-looking mechanism that we adopt today achieves these goals. Because the forward-looking mechanism provides a definitive amount of support on a per line basis, we conclude that it meets section 254's specificity goal. In addition, because the cost model and support methodology are available to the public and will change only through Commission action after notice and comment, carriers can predict the amount of support provided for a given period. Thus, we conclude that the forward-looking mechanism meets section 254's predictability goal. Moreover, commenters generally have not suggested that the new forward-looking mechanism fails to satisfy the specificity and predictability goals. Therefore, we believe that our primary focus at this stage of this proceeding should be on section 254's sufficiency goal.

<sup>162</sup> See *supra* section IV.B. See also New York comments at 7.

<sup>163</sup> *Second Recommended Decision*, 13 FCC Rcd at 24761-62, para. 43.

*Inputs Further Notice.*<sup>164</sup> We received numerous comments in response to this request.<sup>165</sup> Commenters proposed benchmarks ranging from 80 percent to 200 percent of the national average forward-looking cost per line.<sup>166</sup> For the reasons discussed below, we select 135 percent as the appropriate national cost benchmark.

**b. Discussion**

54. In establishing a national cost benchmark to enable reasonably comparable rates among states, we observe that the 1996 Act does not define the term "reasonably comparable." We find that Congress's use of the term "reasonably" indicates its recognition that the task of setting federal support amounts is not an exact science. Accordingly, consistent with our interpretations of "reasonableness" provisions elsewhere in the statute, we conclude that the term "reasonably comparable" leaves us substantial discretion to determine what is reasonable, including the manner in which we make that determination. The Joint Board interpreted the reasonable comparability standard to refer to a "fair range" of urban and rural rates both within a state's borders, and among states nationwide.<sup>167</sup> In the *Seventh Report and Order*, the Commission adopted the Joint Board's interpretation.<sup>168</sup> The Commission recognized, however, that reasonably comparable does not mean that rate levels in all states, or in every area of every state, must be the same.<sup>169</sup> Therefore, we believe that reasonably comparable must mean some reasonable level above the national average forward-looking cost per line, i.e., greater than 100 percent of the national average. In interpreting "reasonably comparable," we must consider the burden placed on below-benchmark states (and ratepayers) whose contributions fund the federal support mechanism. We also must ensure that the benchmark we select, when taken together with other aspects of the overall funding mechanism, allows for universal service support that is specific and predictable.

55. We conclude that the level of the national benchmark should be set at 135

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<sup>164</sup> *Seventh Report and Order*, 14 FCC Rcd at 8124, para. 97.

<sup>165</sup> See, e.g., Ameritech comments at 9; AT&T comments at 7-8; BellSouth comments at 5-6; CBT comments at 3-4; California comments at 8-9; ITCs comments at 4; New York comments at 4; PRTC comments at 3-4; Sprint comments at 15-16; US West comments at 18; Vermont comments at 8-9; West Virginia comments at 9.

<sup>166</sup> See, e.g., AT&T comments at 7-8 (200% benchmark); ITCs comments at 3-4 (115% benchmark); Sprint comments at 15 (150% benchmark); US West comments at 18 (115% benchmark); Vermont comments at 14 (80% benchmark); West Virginia comments at 9 (135% benchmark); Western Wireless comments at 8 (150% benchmark at a minimum).

<sup>167</sup> *Second Recommended Decision*, 13 FCC Rcd. at 24753, para. 15. This definition of reasonable comparability contradicts, for example, ITCs' assumption that the goal of reasonable comparability should refer to *equality* of rates. ITCs comments at 3-4.

<sup>168</sup> *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30.

<sup>169</sup> *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30.



percent of the national average forward-looking cost per line for non-rural carriers. The federal mechanism will provide support for costs that exceed this national benchmark. A national benchmark of 135 percent falls within the range recommended by the Joint Board, and ensures that no state will face costs greater than 35 percent above the national average cost per line. Moreover, setting the benchmark at 135 percent of the national average forward-looking cost is consistent with the precedent of the existing support mechanism and the comments we have received. The current mechanism begins providing support for costs between 115 and 160 percent of the national average cost per line, based on carriers' books, and the vast majority of non-rural carriers receive all their current support for costs in this range.<sup>170</sup> The new national benchmark of 135 percent is near the midpoint of this range. Commenters generally proposed benchmark levels between 80 and 200 percent of the nationwide average.<sup>171</sup> Vermont and US West, for example, advocated benchmarks of 80 percent and 115 percent, respectively.<sup>172</sup> California stated that it uses an affordability benchmark of 150 percent.<sup>173</sup> CBT, Sprint, and Western Wireless also advocate a 150 percent benchmark, and AT&T urges us to use a 200 percent benchmark.<sup>174</sup> Thus, the 135 percent benchmark is a reasonable compromise of commenters' proposals. By adopting this benchmark, we do not mean to suggest that we could not, in consultation with the Joint Board, determine that a different level of benchmark is appropriate in future proceedings. In the context of non-rural carriers, and in light of the overall methodology we adopt here and the specific circumstances before us, however, we believe that the benchmark we adopt appropriately balances various goals under the statute. These goals include, among others, sufficiency, specificity, and predictability, as well as the need to achieve rate comparability. In addition, we have also attempted to ensure that the fund is no larger than necessary, and to minimize burdens on carriers and consumers that contribute to universal service mechanisms.

56. We believe that this level of support will provide states with the ability to provide for a "fair range" of urban and rural rates within their borders,<sup>175</sup> and will be sufficient to "prevent pressure from high costs and the development of competition from

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<sup>170</sup> That is, very few non-rural carriers have book costs that exceed 160 percent of the nationwide average. For a more detailed description of the current support mechanism, *see supra* section III.A.1.

<sup>171</sup> *See, e.g.*, Vermont comments at 14 (80% benchmark); AT&T comments at 7-8 (200% benchmark); ITCs comments at 3-4 (115% benchmark); Sprint comments at 15 (150% benchmark); US West comments at 18 (115% benchmark); West Virginia comments at 9 (135% benchmark); Western Wireless comments at 8 (150% benchmark at a minimum).

<sup>172</sup> Vermont comments at 14 (80% benchmark); US West comments at 18 (115% benchmark).

<sup>173</sup> California reply comments at 4.

<sup>174</sup> Sprint comments at 15 (150% benchmark); Western Wireless comments at 8 (150% benchmark at a minimum); AT&T comments at 7-8 (200% benchmark).

<sup>175</sup> *Second Recommended Decision*, 13 FCC Rcd at 24753, para. 15. *See also Seventh Report and Order*, 14 FCC Rcd at 8091, para. 29.

causing unreasonable increases in rates above current, affordable levels."<sup>176</sup> Because no state will face costs, net of federal support, that exceed 135 percent of the national average, the federal mechanism will prevent excessive upward pressure on rates caused by high costs. This will remain true even as competition develops and pushes prices toward economic cost. We therefore find that using a benchmark set at 135 percent of the national average forward-looking cost per line will, at this time, in light of the facts before us, provide sufficient support to enable reasonably comparable rates.

57. We recognize that, irrespective of our policies, the development of competition may place pressure on implicit support mechanisms at the state level. For example, states that use above-cost pricing in urban areas to subsidize below-cost service in rural areas may face pressure to deaverage rates as competitors begin to offer cost-based rates to urban customers. Although this development may compromise states' ability to facilitate universal service using implicit support, it should not compromise states' ability to facilitate universal service through explicit support mechanisms. In addition, we do not believe it would be equitable to expect the federal mechanism – and thus ratepayers nationwide – to provide support to replace implicit state support that has been eroded by competition if the state possesses the resources to replace that support through other means at the state level. This approach is consistent with our discussion, above, of the appropriate, respective roles of the state and federal jurisdictions in providing universal service support.

58. We also believe that a national benchmark of 135 percent strikes a fair balance between the federal mechanism's responsibility to enable reasonable comparability of rates among states and the burden placed on below-benchmark states (and ratepayers) whose contributions fund the federal support mechanism. We recognize that selecting the national benchmark is not an exact science. We conclude, however, that a national benchmark of 135 percent of the national average cost per line will allow the federal mechanism to provide sufficient support pursuant to the Act,<sup>177</sup> while at the same time minimizing the burden on those who fund the federal support mechanism. Moreover, we believe that, given the specific circumstances here, the mechanism we adopt today is consistent with the Joint Board's conclusion that the federal high-cost support fund should be only as large as necessary, consistent with other requirements of the law.

59. Some commenters have suggested that our choice of a benchmark will necessarily be arbitrary,<sup>178</sup> and some have suggested that we will intentionally set the benchmark with an eye to minimizing the size of the federal support mechanism.<sup>179</sup> We reject these claims. We remain committed to the objective that the fund not be any larger than is

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<sup>176</sup> *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30.

<sup>177</sup> 47 U.S.C. § 254(b)(5), (d).

<sup>178</sup> *See, e.g.*, Ameritech comments at 9.

<sup>179</sup> *See, e.g.*, BellSouth comments at 7-8.